



### Macroeconomic Environment:

- In the 1<sup>st</sup> quarter of 2014, GDP (in seasonally adjusted terms) contracted by -4.1% compared with -4.9% in the 4th quarter of 2013 on an annual basis. The contraction was mainly due to the subdued performance of the secondary sector (construction, manufacturing) and the financial sector. From the expenditure side, the contraction was more pronounced in investments of construction, while net exports made a positive contribution.
- The business operating environment remains constrained, given that lending to non-financial corporations is subdued and interest rates are still relative to economic conditions high. We maintain our view that growth in 2014 will remain negative, around 3½-4%, and we assume a rebound in 2015 with a gradual restoration of lending at affordable rates.
- Exports of goods decreased by 7.1% in January-May 2014 compared to the corresponding period in 2013.
- In January-June 2014 tourist arrivals increased by 6% compared to the corresponding period in 2013. An increase of 1.4% was recorded in arrivals from the United Kingdom, a 3.7% decrease in arrivals from Greece and a 17.6% increase in arrivals from Russia.
- Inflation as measured by the HICP, stood at 0% in June 2014 compared to -0.1% in May 2014 and for 2014 so far it stands at -0.7%.
- Labour Force Survey (LFS) unemployment, in monthly seasonally adjusted figures, decreased from 15.9% in May 2013 to 15.3% in May 2014. The most affected segment of the population is youth. Particularly worrying is also the rapid increase in long-term unemployed.
- Compensation per employee in the 1<sup>st</sup> quarter of 2014 declined by around 4.5% compared to the 1<sup>st</sup> quarter of 2013, contributing to a decline of nominal unit labour costs and improving cost competitiveness further. The observed wage adjustment is expected to help containing the upward pressure on unemployment.

### Banking Sector:

- We are currently focusing in addressing rising NPLs through the introduction of various measures that will have an impact over the medium term such as the implementation of an arrears management directive, adopting a functioning foreclosure law while protecting vulnerable groups and modernizing our insolvency framework. We expect to have the relevant regulatory framework in place by the end of the year.
- The largest credit institution in Cyprus, Bank of Cyprus, is close to successfully completing (end of August 2014) a capital increase exercise, and is proceeding with implementing its restructuring plan.
- Large banks (BoC, Coops, Hellenic Bank, RCB) are participating in the on-going Comprehensive Asset Quality Review and Stress test of the ECB, due to be completed by the end of Oct-2014.

- Taking into account indicators of confidence in the banking system and financial stability indicators, including the liquidity situation of credit institutions, we have gradually, fully abolished all domestic restrictions on transactions.
- We intend to proceed with the Road map based approach in examining the external restrictions, aiming towards their gradual relaxation and eventual abolition, while ensuring consistency with financial stability.

#### Cooperative Credit Institutions:

- Publication of the consolidated audited accounts for 2013.  
( <http://www.coopbank.com.cy/content/The%20Bank/COOPconsolFS2013.pdf> )
- The Cooperative Central Bank submitted in May 2014, the first quarterly report describing the progress with the implementation of the restructuring plan.  
Publication of Key Performance Indicators regarding the progress achieved in the implementation of the restructuring plan.  
( [http://www.coopbank.com.cy/index.php?option=com\\_content&view=article&id=1229&Itemid=563](http://www.coopbank.com.cy/index.php?option=com_content&view=article&id=1229&Itemid=563) )
- Completion of the recruitment of the senior management team at the Cooperative Central Bank and Cooperative Credit Institutions level.
- Enhancement of the operational capacity of the central NPL Management Division that was set up in the Cooperative Central Bank to handle the sector's most problematic clients and all terminated accounts. The main pillars of the Division is the Arrears Management & Restructuring Unit, Debt Recovery Unit and Property Management Unit.

#### Fiscal Developments:

- Developments in public finances continue to exceed expectations.
- General government budget balance (GGBB) was in deficit during the first half of 2014, of the order of €22 mn (-0.1% of GDP) compared to a forecast deficit of -€145 mn (-0.9% of GDP).
- General government primary balance (GGPB) was in surplus during the first half of 2014, of the order of €171 mn (1.1% of GDP) compared to target surplus of €46 mn (0.3% of GDP).
- Total revenue reached €3,180 mn during the first half of 2014, in line with the forecast.
- Total expenditure reached €3,202 mn during the first half of 2014, exhibiting a decline of €124 mn vis-à-vis the forecast.
- In accordance with the macroeconomic scenario agreed during the 5<sup>th</sup> review, the budget balance is estimated to exhibit an improvement with the deficit falling to 4.7% of GDP in 2014 compared to a deficit of 5.4% the year before.

#### Public debt and financing:

- The Republic of Cyprus issued a five year EMTN bond on the 25<sup>th</sup> of June through a syndicated issue. The issue was for an amount of €750 mn and a coupon of 4,75% (4,85% yield).

- On the 1<sup>st</sup> of July the Republic proceeded to a partial early repayment of the bank recapitalization bond held by the Bank of Cyprus (yield 5,15%) for an amount of €950 mn. The transaction had the following effects on the Bank:
  - a. Reliance on ECB funding, including ELA, was reduced by €950 mn
  - b. Accounting profits of €95 mn were recorded on the transaction
  - c. Common equity tier 1 Capital was increased by €95 mn
- DBRS upgraded the Republic of Cyprus from CCC to B(low) on the 27<sup>th</sup> of June 2014.
- The General Government Debt remained broadly stable at €18.56 bn at the end July 2014 (preliminary data) vis-a-vis the end of December 2013 when it was €18.4 bn.
- Average short term debt yields have continued to drop in June and July with short term rates falling at 4.22% in the end of July from to 4.48% at the end of Q1 2014.
- Long term bond yields exhibited relative stability during the period of June-July remaining around the 5% mark despite the number of negative news regarding the external environment faced by the Republic and the continuing crises in Ukraine and the Middle East.
- The 5<sup>th</sup> Programme tranche was disbursed in July 2014 amounting to a total of €683 mn
- Next Programme disbursements are scheduled in September-October 2014 from the ESM (€350 mn) and the IMF (74.3 mn SDR; est. around €85 mn depending on exchange rate)

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**Links:**

Macroeconomic monitor:

[http://www.mof.gov.cy/mof/mof.nsf/page23\\_en/page23\\_en?OpenDocument](http://www.mof.gov.cy/mof/mof.nsf/page23_en/page23_en?OpenDocument)

Public Debt Quarterly Bulletin:

<http://www.mof.gov.cy/mof/pdmo/pdmo.nsf/All/F0C650FEBD5E4C11C225788D00208D2A?OpenDocument>

Roadmap on relaxation of capital controls:

[http://www.mof.gov.cy/mof/mof.nsf/All/3766C4D62B9EDE71C2257BC2002E22E9/\\$file/Roadmap%20PresentationLHM07%2008%202012ENG%20\[Compatibility%20Mode\].pdf](http://www.mof.gov.cy/mof/mof.nsf/All/3766C4D62B9EDE71C2257BC2002E22E9/$file/Roadmap%20PresentationLHM07%2008%202012ENG%20[Compatibility%20Mode].pdf)

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The information has been compiled and verified to the best of our knowledge. The possibility of a factual mistake can not, however, be excluded